Regulators worldwide have been pushing banks to address their culture and conduct issues for many years. In Asia-Pacific, Singapore, Hong Kong and Australian regulators have recently been vocal about the importance of establishing and implementing a risk culture framework to supplement current risk management practices within banks. In 2018, regulators in Mainland China released its first set of guidelines setting out conduct requirements for bank staff.

Background
The Hong Kong Monetary Authority (HKMA) and the China Banking and Insurance Regulatory Commission (CBIRC), among other regulators in Asia, believe that establishing sound culture and corporate governance within the financial services industry is paramount to maintaining the integrity of the industry and protecting bank customers. Misconduct bred by poor corporate culture can wreak havoc on a bank’s reputation as well as lead to massive fines, individual imprisonment, or even the complete loss of a banking license. The lack of sound risk culture is frequently cited as a key enabler of mis-selling and money laundering, whereas a strong risk culture mitigates conduct risk by providing an environment where bank staff is driven to do “the right thing”, which promotes trustworthiness and stability in the financial services sector.

However, the timeline of delivery and stringency of policy vary significantly across jurisdictions. For example, on 20 March 2018, the CBRC (now the CBIRC) published its Guidelines for the Management of Conduct of Practitioners of Banking Financial Institutions (the Notice) to facilitate secure and sustainable operations of banks. To date, the Notice is the first and only guideline on bank staff conduct released in Mainland China.

On 19 December 2018, the HKMA issued a circular, Supervision for Bank Culture, which focused on governance, incentive systems, assessment and feedback mechanisms. The circular obligated banks to conduct self-assessments and report on their governance arrangements and culture enhancement measures. The HKMA pledged to conduct focus reviews and undertake culture dialogues to assess and benchmark banks’ culture practices. The circular was issued as a follow-up action to the a Bank Culture Reform circular, issued by the HKMA in 2017.

In this article, we will compare the regulatory requirements and frameworks on culture and conduct between Mainland China and Hong Kong, using the common example of misconduct in the selling process of investment products, and conclude with the key implementation pain points.

Similar Issues Across Mainland China and Hong Kong
Unethical or immoral behavior in banks is most often motivated by a desire for personal gain, at the direct or indirect expense of the bank or its customers. Front line staff is subjected to more frequent and close monitoring for misconduct, as they are positioned in ways that enable them to facilitate or hide illicit activities, earning commission from sales that may ignore client interests.

Back in 2017, a leading Chinese private bank was hit with the highest fine of the year for the issuance and sales of fake wealth management products to customers. The CBRC imposed a fine of approximately USD 4.2 million on the bank’s Beijing branch for having defrauded over 150 of its high net-worth private banking customers of as much as CNY 3 billion (approx. USD 440 million), by means of counterfeit wealth management products.
products that were subsequently discovered by the bank itself to be counterfeits with fake serial numbers. The incident led to the issuance of the Provisions of Audio and Video Recording in Sales Section⁶, which required banks to set up a specific area for sales activities, and to store audio and video recordings of the sales process to safeguard against misconduct of the sales staff.

Following suit, HKMA released the circular on Misconduct Risks in Selling of Investment Funds in December 2018⁷, to raise awareness towards misconduct risk in the sales of investment funds, and to set clear standards for the prevention and management of such mis-selling. The circular also specified culture-related and ethical standards for front line and control function staff to ensure compliance meets client suitability requirements.

Conduct Frameworks in Mainland China and Hong Kong

It is widely acknowledged by both regulators and industry practitioners that promoting a strong risk culture and fostering a trusting relationship between banks and their customers builds reputation that ultimately generates sustainable financial and non-financial value.

In China, the Notice focused on the topics of governance frameworks, staff conduct management and oversight from regulators. Banks are required to establish an effective internal governance framework that explicitly specifies responsibility and ownership among the board of directors, the board of supervisors, senior management and relevant functional departments in the management of practitioners’ conduct. In addition, banks should have a risk-based control framework to prevent misconduct. Appropriate reporting systems that enable regular updates and timely notifications about major incidents to financial regulators is a must for a successful implementation.

In its March 2017 circular, the HKMA provided a three-pillar framework for promoting a sound bank culture. It emphasized that the culture initiative was not a box-checking exercise. Rather, banks were advised to take it as an opportunity to thoroughly assess their policies and procedures, among other internal controls.

In the governance framework, the HKMA requires banks to set an appropriate «tone from the top», obligating the senior management to lead the bank culture efforts by example. A thorough assessment of performance evaluation systems is also required to avoid inadvertently incentivising excess risk-taking for short-term business performance gains that would endanger the interests of the bank and its customers. Banks are also required to review the efficiency of internal escalation systems for reporting questionable practices. The complexity of this initiative is enormous, given the level of communication and cooperation required between all levels and areas of large banks.

Staff conduct in Mainland China is, in most cases, managed by a stick that penalizes wrongdoing rather than a carrot that promotes the right behaviors. Behavior is closely monitored and measured against the unethical practices. This is in stark contrast to Hong Kong, where doing the «right thing» is promoted by the conduct framework in a more preventative manner, rather than solely relying on punitive measures to incentivize appropriate conduct. Beyond their philosophy towards staff incentives, similarities in overall direction can be seen when comparing the conduct frameworks (2(1)) provided by regulators in Mainland China and Hong Kong.

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⁶ The Interim Provisions on the Administration of Audio and Video Recording in Sales Sections of Banking Financial Institutions, issued by CBRC on 2017-8-2

⁷ Misconduct Risks in Selling of Investment Funds, issued by HKMA on 2018-12-21
Governance for Clear Ownership and Responsibilities at Board Level
Banks in Mainland China and Hong Kong are both required to establish sound governance structures with a clear tone from the top, and the board is required to take the lead. Senior management teams are required to set up an effective system for conduct management, which should be supervised by a board-level committee.

Incentives Systems Realigned to Reward Positive Risk Behavior
Banks are discouraged for overly relying on sales and revenue targets in performance measurement. Besides financial performance, incentives also need to include risk and behavioral metrics. There should be adequate consideration of behavioral and risk indicators, and separation of the performance rating that measures adherence to corporate values and balanced use of incentives and disincentives. In both Mainland China’s and Hong Kong’s Guidelines, the consideration of risk behavior should be factored into a bank’s incentives policies and processes, including in relation to performance management, talent programs, career progression paths and financial compensation.

Assessment and Feedback Mechanisms for Whistle Blowing
Both Mainland China and Hong Kong regulators emphasize the importance of establishing internal reporting mechanisms to prevent unethical behavior and report when it occurs. For example, the Notice made it clear that the banks must at least report annually on staff conduct assessments, which should be connected to remuneration arrangements. In Hong Kong, banks are required to review and report their governance arrangements as well as policies and procedures in relation to corporate culture and the implementation of the enhancement measures to foster a sound bank culture.

Challenges in Managing Culture and Conduct
In many ways, banks are facing similar challenges today as they were before. Change is still driven mostly by regulators, and the ongoing progress made by banks has been rather slow. Accurate and effective management of information across the organization is often a limiting factor, and a major hurdle for efficient change projects. How a cultural initiative can be transformed into visible practices, such as procedures and process manuals, topic campaigns and measurable parameters for assessment and reporting, becomes crucial. However, culture initiatives are still often seen as mere box-ticking exercises, rather than as an important part of a modern bank.

Therefore, regulators are intensifying pressure on banks to shift from a compliant risk culture towards an embedded one, which affects numerous aspects of these organizations. Banks in Asia are now facing two key challenges: (i) identifying gaps in their current risk culture setup and (ii) setting up the right risk framework.

Especially for banks that operate in Mainland China, where the conduct initiative is comparably new, guidance will be needed to establish a culture and conduct framework that satisfies the expectations of the regulator. Common pain points faced by banks in the construction of risk frameworks in a compliant way include, but are not limited to:

- Overreliance on regulators to drive progress on culture and conduct;
- Lack of a thematic review approach, where risk is considered and measured holistically throughout business activities, roles and responsibilities;
- Inadequate training programs and awareness campaigns, which are currently not capable of producing long-term results when compared to full-fledged frameworks;
- Lack of predictive behavioral analytics and data-driven incentive programs with transparent measuring tools;
- Underdeveloped culture of personal accountability, leading to low efficiency of feedback and escalation systems.

Conclusion
Synpulse is dedicated to providing industry best practice advice to banks to help in the design and implementation of risk culture frameworks. Our insights on how private banks are currently taking action to embed a sound risk culture, and how different frameworks can be benchmarked, can be found in our commentaries:

- «The Impact of Culture and Conduct — Industry’s Biggest Blind Spot»
- «In Search of Banks’ Moral Compass»
Leveraging on our experience in helping some of the largest banks in Greater China, Singapore and Australia design and implement holistic culture and conduct frameworks, we can help you to drive forward maturity assessment, culture framework design and industry benchmarking initiatives.

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